

Internal Revenue Service
District Director

Department of the Treasury
Post Office Box 11202
Brooklyn, NY 11202

Date: MAY 18 1996

Person to Contact:

Contact Telephone Number:

Refer Reply to:
EO 7321

Employer Identification Number:

CERTIFIED MAIL

Dear Applicant:

We have considered your application for tax-exempt status under section 501(c)(3) of the Internal Revenue Code.

The evidence presented disclosed that the corporation was incorporated in the state of [REDACTED] on [REDACTED].

The Articles of Incorporation described the organization's purposes as follows:

The general purpose, or mission of [REDACTED] shall be to facilitate the creation of new products by reducing the risks of invention, development, and market introduction and any other lawful purpose of a non-profit corporation. Specifically, [REDACTED] shall: 1) undertake serving the interests of its membership; 2) provide innovation support to individual inventors, businesses, and government; 3) encourage the process of invention by fostering the creation and realization of new ideas and products; and 4) promote education, communication, and development of its members.

The organization's core members consists of an independent group of inventors and business individuals dedicated to converting ideas into successful ventures.

The organization's dominant activity is to assist inventors by providing guidance, product review and disclosure in a protected environment, evaluation by a panel of technical experts, technical assistance from idea through manufactured prototype and marketing intelligence. The above is accomplished through the following five steps:

- 1) Individuals, businesses, or government submit any form of idea to the organization. The organization then decides which idea it will accept.

2) The organization assembles a team of specialists to build a prototype.

3) The organization investigates and conducts research to find out if the idea is original. If an original, the organization obtains patent, copyright, etc.

4) The organization determines retail/wholesale markets (i.e. analyze market and develop strategy).

5) The organization sells the idea to manufacturers.

Pursuant to the organization, charges for its services depends on the need to hire different specialists, different machinery, tools, direct expenses to complete the project, and depending upon the commercial viability and nature of royalties that can be anticipated from the particular project, it will divide a percentage of such royalties with the inventor or small business on a fair basis commensurate with its involvement and expenses.

The organization also indicated that it has been working with the States of [REDACTED] and [REDACTED] along with NASA in investigating the lead in maple syrup problem, and assisting them with financing a solution to this problem. The organization was contacted with respect to this activity and it was ascertained that the organization's only function was to act as a coordinator. It did not perform scientific research with respect to this activity.

In addition to the above, the organization indicated that it is exploring new and innovative ways to provide science and technology support to local rural school systems.

Receipts of the organization consist of contributions and royalty revenue. The expenditures include equipment, technical/marketing/research expenses, legal/accounting expenses, technology research expenses, market research expenses, other salaries and wages, occupancy and depreciation.

Section 501(c)(3) of the Code provides, in part, for the exemption from Federal income tax of organizations organized and operated exclusively for charitable, religious, scientific or educational purposes, no part of the net earnings of which inures to the benefit of any private shareholder or individual. In order to qualify under IRC 501(c)(3), an organization must be both "organized" and "operated" exclusively for one or more purposes specified in that section. If the organization fails to meet either the organizational test or the operational test, it is not exempt. (Regs. 1.501(c)(3)-1(a)(1)). The organizational test relates to the rules for governing an organization and the purposes stated in its articles of organization. The operational test relates to the organization's activities.

Section 1.501(c)(3)-1(c)(1) of the Regulations states that if more than an insubstantial part of an organization's activities is not in furtherance of exempt purposes, the organization will not be regarded as exempt.

In Butter Business Bureau v. U.S., 326 U.S. 279 (1945), the Supreme Court stated that the presence of even a single, non-exempt purpose, if more than insubstantial in nature, will defeat exemption under Section 501(c)(3) of the Code, regardless of the manner or importance of the truly exempt purposes.

Section 1.501(c)(3)-1(d)(1)(ii) of the Regulations provides, in part, that an organization is not organized or operated exclusively for one or more of the purposes mentioned in section 501(c)(3) of the Code unless it serves a public rather than a private interest. An organization may not be exempt if it is operated for the benefit of private individuals.

Section 1.501(c)(3)-1(d)(2) of the Regulations provides that the term "charitable" includes relief of the poor and distressed, advancement of education and science and the promotion of social welfare designed to accomplish any of the above purposes.

Section 1.501(c)(3)-1(d)(3) of the Regulations provides, in part, that the term "educational" relates to the instruction of the public on subjects useful to the individual and beneficial to the community. Museums and schools are included in the examples of educational organizations which, if they otherwise meet the requirements of section 501(c)(3) of the Code, may qualify under this section.

Section 1.501(c)(3)-1(d)(5) of the Regulations defines a "scientific" organization as one carrying on scientific research in the public interest; this includes research carried on the purpose of discovering a cure for a disease, research for the purpose of aiding in the scientific education of college or university students, and research for the purpose of obtaining scientific information to be published.

Section 1.501(c)(3)-1(d)(5)(iii) of the Regulations states that "scientific research will be regarded as carried on in the public interest (a) if the results of such research (including any patents, copyrights, processes, or formulae resulting from such research are made available to the public on a nondiscriminatory basis; (b) if such research is performed for the United States, or any of its agencies or instrumentalities, or for a State or political subdivision thereof; or (c) if such research is directed toward benefitting the public."

Revenue Ruling 65-1, 1965-1, C.B. 226 holds that an organization which promotes and fosters the development and design of machinery in connection with a commercial operation, and in connection therewith has the power to sell, assign, and grant licenses with respect to its copyrights trademarks, trade name

or patent rights. does not qualify for exemption from Federal income tax under section 501(c)(3) of the Internal Revenue Code.

In Revenue Ruling 71-506, 1971-2 C.B. 233, it was held that an engineering society formed to engage in scientific research in the area of heating, ventilating, and air conditioning for the benefit of the general public qualifies for exemption under section 501(c)(3) of the Code. The research of the society was devoted exclusively to the development of data on basic physical phenomena, which data might be used by any person who elected to do so. The society did not perform commercial tests nor issued reports on commercial products, and it has no financial interest in the scientific information it developed. All such information was made freely available to the public. In addition, by operating a library, disseminating the research results, and making available the model codes, the society was instructing the public on subjects useful to the individual and beneficial to the community.

The organization's purpose or mission as mentioned above clearly does not meet the requirements as set forth in section 501(c)(3) of the Code. Furthermore, the organization's articles of association do not contain any clause limiting its purpose or mission to those specified in section 501(c)(3) of the Code. Therefore, the organization does not meet the organizational test as required pursuant to Regs. 1.501(c)(3)-1(a)(1).

Accepting ideas, in view of building a prototype to be available to manufacturers, and whereby depending upon the commercial viability royalties will be shared by the organization and inventors, it is clear that the organization is conducting a commercial operation. This activity does not constitute scientific research within the meaning of section 1.501(c)(3)-1(d)(5) of the regulations. Furthermore, the development of new ideas/inventions, the copyrights, patents, etc. which may be licensed on a restricted basis to selected manufacturers is directed toward benefitting those particular manufacturers, inventors, and members of the organization, and any benefit to the public must be considered indirect. See Revenue Ruling 65-1.

Unlike the society in Revenue Ruling 71-506, your organization undertakes projects based upon their commercial viability and in which you and all parties involved have a financial interest. This clearly indicates that the organization is operating in a commercial manner and not within the meaning of section 1.501(c)(3)-1(d)(5) of the regulations. Therefore, like the organization in Revenue Ruling 65-1, the instant organization is neither organized nor operated for scientific or any other purpose described in section 501(c)(3) of the Code.

Accordingly, we conclude that you do not meet the requirements for exempt status under section 501(c)(3) of the Code and propose to deny your request for exemption under that section.

You are required to file a taxable return Form 1120 or 1041 with the District Director of Internal Revenue Service. Please send the return to the Internal Revenue Service, P.O. Box 1680, General Post Office, Brooklyn, NY 11202.

Contributions made to you are not deductible by the donors as charitable contributions as defined in section 170(c) of the Code.

If you do not agree with this determination, you may request a Conference with the Regional Director of Appeals by protesting in accordance with the enclosed instructions within 30 days.

Protests submitted which do not contain all the documentation stated in the instructions will be returned for completion.

If we do not hear from you within that time this determination will be considered final and the appropriate State Officials will be notified.

If you do not protest this proposed determination in a timely manner, it will be considered by the Internal Revenue Service as a failure to exhaust available administrative remedies. Section 7428(b)(2) of the Internal Revenue Code provides in part that "A declaratory judgment or decree under this section shall not be issued in any proceeding unless the Tax Court, the Claims Court, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted administrative remedies available to it within the Internal Revenue Service."

S. F. B. L. 10/11/71


District Director

Enclosure: Publication 892